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In The

Supreme Court of the United States

KLEIN & CO. FUTURES, INC.,

Petitioner

v.

BOARD OF TRADE OF THE CITY OF NEW YORK, INC., *et al.*

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Commodity Exchange Act provides an express private right of action for actual losses to a person who "engaged in any transaction on" or "subject to the rules of" a commodity board of trade against that board of trade if the board, in bad faith, engaged in illegal conduct that caused the person to suffer the actual losses, 7 U.S.C. § 25(b)(1).

The question presented is:

Whether the court of appeals erred in concluding that futures commission merchants lack statutory standing to invoke that right of action because, in the court's view, they do not engage in such transactions, despite the statutory requirement that the merchants enter into and execute their transactions on, and subject to the rules of, a board of trade and the fact of the merchants' financial liability for the transactions.

PARTIES TO THE PROCEEDING

Petitioner is Klein & Co. Futures, Inc. The respondents to the proceeding in the court whose judgment is sought to be reviewed are the Board of Trade of the City of New York, Inc.; the New York Clearing Corporation; the New York Cotton Exchange, Inc.; and the New York Futures Exchange.

Mark D. Fichtel; Albert Weis; Jeff Soman; Charles Sweeney; Al Peres; Chris Meek; George Haase; Lawrence Gulitti; Bryan Sayler; Nitesh Trivedi; Joseph O'Neill; Walter Fair; Evan Thomas; and Joseph Jach also were appellees in the court below, but petitioner does not seek review of the court of appeals' ruling affirming their dismissal from the dispute.

Norman Eisler and First West Trading, Inc. were defendants in the proceedings before the United States District Court, but petitioner did not appeal their dismissal from the dispute.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of the Rules of the Supreme Court, petitioner Klein & Co. Futures, Inc. hereby states that it has no parent company, and no public company owns 10% or more of its stock.

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PETITION FOR A WRIT OF CERTIORARI

Klein & Co. Futures, Inc. (Klein) respectfully petitions for a writ of *certiorari* to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit (App., *infra*, 1a-15a) is reported at 464 F.3d 255 (2006). The opinion of the United States District Court for the Southern District of New York granting respondents' motion for summary judgment (App., *infra*, 16a-34a) is unreported.

JURISDICTION

The court of appeals entered its judgment on September 18, 2006. A petition for rehearing and rehearing *en banc* was denied on November 14, 2006. Justice Ginsburg, on January 31, 2007, granted an extension of time within which to file a petition for a writ of *certiorari* to and including March 14, 2007. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, as in effect on July 26, 2000, when this case was filed,[1] provides in relevant part:

[1] The statute was amended on December 21, 2000 but the amendments to this section of the statute were merely technical.

Sec. 25 Private rights of action

* * *

(b) Liabilities of organizations and individuals; bad faith requirement; exclusive remedy

(1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by sections 7(a)(8) and 9 of this title,

(B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or

(C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order,

shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

7 U.S.C. § 25(b)(1).

Other relevant provisions of the Commodity Exchange Act are set forth in the appendix to this brief at App., *infra*, 37a-41a.

INTRODUCTION

Almost two billion contracts are traded in the United States futures market annually, and more than $100 billion of equity is invested in this market. Congress, in

enacting the Commodity Exchange Act, recognized that a stable commodities futures market is vital to the financial well-being of the nation. If left unreviewed, the ruling below will impose significant costs on trading on the futures markets and undermine those markets' stability.

The court of appeals below denied to futures commission merchants, who are statutorily authorized market participants, a private right of action against the boards of trades and clearinghouses that operate the markets. Congress created that private right of action as a means to protect against market manipulation. The inability of these merchants to recover actual losses caused by a board of trade's bad faith violation of the governing statute, regulation, or rules will substantially undermine enforcement of those laws. Without the right of action, the risk of economic loss rests on the merchants rather than on the wrongdoers who cause or are required to enforce rules designed to prevent the actual losses. That risk of loss will be spread to investors, which will contribute to a more inelastic and expensive commodities market that ultimately will be more susceptible to price manipulation.

The ruling below stands in conflict with other circuits on the role of futures commission merchants under the statutory framework. The court of appeals' denial to futures commission merchants of their private right of action is rooted in that court's fundamental misunderstanding of the role of such merchants as federally regulated entities in a multi-faceted enforcement scheme constructed by Congress. By contrast, the Seventh Circuit (the other jurisdiction in which many commodity exchanges are concentrated) and other circuits correctly recognize the role that Congress intended these merchants to play as entities that engage in transactions subject to the rules of a board of trade.

This Court should grant the petition for a writ of *certiorari* to address this issue of national economic importance and reverse the clearly erroneous

interpretation of the Commodity Exchange Act that undermines the regulation of the nation's futures markets.

STATEMENT OF THE CASE

1. Statutory And Regulatory Framework

a. A futures contract is an agreement to buy or sell on a commodity exchange a quantity of a particular commodity in the future. The parties to a futures contract agree on a price for the commodity to be delivered, or paid for, at a set time in the future, known as the "settlement date." Most futures contracts are closed prior to the delivery date, however. Thus, the commodity exchange serves, in essence, as a market where investors trade futures contracts to shift the inherent market risks of price increases and decreases onto others who are willing to assume that market risk for profit opportunity.[2]

A commodity exchange is operated by a board of trade, such as respondent, the Board of Trade of the City of New York, which operates a market for, *inter alia*, certain sugar, coffee, and cocoa; and cotton and orange juice contracts. *See* http://www.nybot.com (last visited Mar. 7, 2007). A clearinghouse, such as respondent, the New York Clearing Corporation, works with a board of trade to clear the trades on the exchange.

In order to protect the public from price manipulation on these robust, high-volume markets, Congress has subjected boards of trade and their participants to extensive oversight, through the Commodity Exchange Act

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[2] Option contracts also are traded on the commodity exchanges. An option contract gives an investor the option (*i.e.*, the right but not the obligation) to enter a particular futures contract on a given day at a particular price. Although the instant dispute involves both futures and option contracts, for the purposes of this petition the distinctions between the two make no difference and we use the term "futures contracts" to refer to both.

(CEA), 7 U.S.C. § 1 *et seq.* Congress has ensured compliance in this self-regulatory statutory scheme through the threat of public and private enforcement. Congress established the Commodity Futures Trading Commission (CFTC) as the primary regulator of boards of trade under the CEA. A board of trade has a statutory obligation to establish rules to prevent market manipulation and to ensure fair and equitable trading on its exchanges. *Id.* § 7(b). Congress has specified that any commodity futures transactions must be "conducted on or subject to the rules of a board of trade." 7 U.S.C. § 6(a)(1).

b. Investors do not buy and sell futures on a commodity exchange. Rather, futures commission merchants ("merchants") engage in and are financially liable for the transactions on a commodity exchange.[3] Futures commission merchants are defined by Congress as individuals or entities that "solicit[] or * * * accept[] orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any contract market." 7 U.S.C. § 1a(20)(A). Merchants may "accept[] any money, securities, or property (or extend[] credit in lieu thereof) to margin, guarantee, or secure any trades or contracts that result or may result therefrom." 7 U.S.C. § 1a(20)(B).

Congress authorized boards of trade to establish rules that allow futures commission merchants "to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization." 7 U.S.C. § 7(b)(3)(C). Merchants use floor brokers to execute the trades on the floor of the exchange. Both merchants and floor brokers must be registered with the CFTC. *See* 7 U.S.C. § 6d(a)(1), f(a).

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[3] A commodity exchange and its board of trade are also known as a "contract market." 7 U.S.C. § 7.

A futures transaction is an ongoing relationship among the investor, the futures commission merchant, and the board of trade and its clearinghouse. An investor who holds an account with a merchant must make a minimum "margin payment" on its contracts, and the level of margin required is established by the rules of the board of trade in accordance with CEA and CFTC regulations. The payment generally is a relatively small percentage of the value of the investor's market position (*i.e.*, the price of the futures multiplied by the quantity of the futures), which allows the investor to leverage his funds.

Settlement prices of commodity contracts are used to determine whether additional margin payments in connection with open contract positions are required. The settlement prices are calculated, on a daily basis, by the board of trade and its clearinghouse for whatever contracts are then being held in the accounts of futures commission merchants who are also clearing members. Settlement prices reflect the daily closing value of the contract and often are at, or very near, the price of the last trade. In thinly traded markets – *i.e.*, where there is infrequent trading – however, there can be a significant difference between the settlement price and the price of the most recent trades.[4] As required by the CEA to maintain the financial integrity of all transactions, each board of trade maintains rules as to how settlement prices are calculated at closing. *See* 7 U.S.C. § 7(b)(5).

If an investor's contracts increase in value during the day, the clearinghouse credits the merchant's account, which, in turn, credits the account that the investor has with the merchant. Conversely, if the investor's contracts

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[4] A number of other factors can contribute to the determination of a settlement price. *See In the Matter of Norman Eisler and First West Trading, Inc.*, CFTC No. 01-14, 2004 WL 77924 at *1-2 (C.F.T.C. Jan. 20, 2004).

lose value during the day, the clearinghouse debits the merchant's account, which, in turn, debits the investor's margin account. *See, e.g.*, NYCC Rules 501-504. This relationship occurs because the clearinghouse transacts only with the clearing member futures commission merchant in a single account, irrespective of the number of accounts that merchant might have with individual investors.

If the balance of an investor's margin account with the merchant declines below the board of trade's minimum margin level, the futures commission merchant requires the investor to provide additional funds to the account to restore the initial margin level to its required percentage of the settlement value of his contract. Failure by an investor to meet such a margin call within the allotted period of time (which can be as little as one hour) permits a merchant to immediately liquidate the investor's contract positions in order to reduce the margin deficiency and risk. If an investor's position is liquidated at a loss, the investor is liable to the merchant for the deficiency. Significantly, however, it is the merchant that is legally liable to the board of trade for the difference. *See* CFTC, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* at 2 (July 2001) ("Clearinghouses look to the funds and credit of clearing FCMs [futures commission merchants] for satisfaction of trading obligations rather than to the actual floor broker, floor trader, or other customer.").

c. In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353 (1982), this Court held that there was an implied private right of action for a violation of the CEA's statutory prohibition against fraudulent and deceptive conduct and its provisions designed to prevent price manipulation.

Shortly after that ruling, Congress enacted express private rights of action for violation of the statute, the implementing regulations, or the rules of a board of trade.

See Futures Trading Act of 1982, Pub. L. No. 97-444, § 235, 96 Stat. 2294, 2322-2324 (1982). Two primary rights of action are set forth in 7 U.S.C. § 25(a)(1) and 25(b)(1).

Section 25(a)(1) provides a private right of action for actual damages against a person (other than a board of trade or futures association) that violates the statute, *e.g.*, an action against merchants and brokers. The right of action is conferred only on four categories of persons: (A) any person that received trading advice from the alleged wrongdoer; (B) any person that made a contract of sale through the alleged wrongdoer or deposited funds with him; (C) any person that purchased from, sold to, or placed an order for purchase with or through the alleged wrongdoer for an option not sold on a board of trade, contract, or interest in a commodity pool; and (D) any person that purchased or sold a contract if the violation by the alleged wrongdoer constitutes a manipulation of the price of the contract or underlying commodity. 7 U.S.C. § 25(a)(1)(A)-(D). The most common action under Section 25(a)(1) is a suit by an investor against a merchant or a broker due to a trading loss by the investor.

Section 25(b)(1) provides a private right of action for actual damages against any board of trade designated as a contract market who fails to enforce any bylaws, rules, regulations or resolutions that the entity is charged by statute with enforcing; against a licensed board of trade that fails to enforce any bylaw, rule, regulation or resolution it is required by the CFTC to enforce; and against any board of trade that enforces such provisions in a manner that violates the statute or a CFTC rule, regulation or order.

That Section 25(b)(1) right of action – the right of action at issue here – is not conferred only on the four categories of persons in Section 25(a)(1)(A)-(D). Rather, it is conferred on any person "who engaged in any transaction on" or "subject to the rules of" the board of trade or clearinghouse, but only "to the extent" of that person's "actual losses that resulted from such transaction and were caused by such failure to

enforce or enforcement of such bylaws, rules, regulations, or resolutions." 7 U.S.C. § 25(b)(1).

The statute confers other specific rights of actions for bylaw or rule violations by registered futures associations, 7 U.S.C. § 25(b)(2), and for violations by individual officers, directors and the like of boards of trade, clearinghouses, or futures associations. 7 U.S.C. § 25(b)(3). Those rights of action are conferred only on the four categories of persons specified in Section 25(a)(1)(A)-(D).

Congress provided that the statutory rights of action are exclusive remedies under the statute in most circumstances. 7 U.S.C. §§ 25(a)(2), 25(b)(5). Congress also specified that a person seeking to hold liable a board of trade or futures association or its officer, director or the like, must establish bad faith on the defendant's part in failing to act or in acting, and that such failure to act or action caused the loss. 7 U.S.C. § 25(b)(4).

2. Factual And Procedural Background

a. Petitioner Klein & Co. Futures, Inc. (Klein) brought this action under 7 U.S.C. § 25 against the various respondents, including the Board of Trade of the City of New York (the Board of Trade), its clearinghouse and various individuals. The case arose out of price manipulation by Norman Eisler who was the chairman of the New York Futures Exchange (the Exchange), which is a division of the Board of Trade, both of which are contract markets under the statute. Eisler was a member of the Exchange's settlement committee.

Eisler owned a company, First West Trading, Inc. (First West), that invested heavily in P-Tech futures – a futures traded on the Exchange. From approximately August 1999 through May 12, 2000, Eisler, as the member of the Exchange's settlement committee who determined the daily settlement prices of P-Tech futures, manipulated the daily settlement prices of those futures to ensure that

his company's contracts appeared profitable and avoided margin calls. *See Matter of Norman Eisler,* 2004 WL 77924 at *2-3.

The CFTC ultimately found that Eisler's deliberate miscalculation of the settlement prices falsely inflated the value of First West's account by, on average, approximately $2 million each day. *Matter of Norman Eisler*, 2004 WL 77924 at *4; *see also id.* at *6. The CFTC found that the Exchange unlawfully failed to enforce its own rules in permitting this manipulation to occur, *Matter of New York Futures Exch., Inc.*, CFTC No. 01-13 (C.F.T.C. July 11, 2001), *available at* http://www.cftc.gov/files/enf/01orders/enfnyfe.pdf (last visited Mar. 7, 2007).

Petitioner Klein was First West's futures commission merchant and, as such, entered into and executed the transactions involving the P-Tech futures and was financially liable for the transactions. Petitioner was required by the rules of the Board of Trade and its clearinghouse, as mandated by the CEA, *see* 7 U.S.C. § 7(b)(5), to determine whether First West's account met petitioner's margin requirements by using the settlement prices issued by the Exchange, prices which, unbeknownst to petitioner Klein, were being manipulated by Eisler. Because of the Board of Trade's failure to follow its rules, the margin requirements due by Eisler to petitioner were, on an ongoing basis, insufficient to cover First West's accounts based on an actual unmanipulated, settlement price. Compl. ¶ 61.

Beginning in March 2000, various affiliates, officers, and agents of the respondent Board of Trade and Exchange received, or became aware of, complaints from various floor trading members of the Exchange regarding the miscalculation of P-Tech futures settlement prices. Respondents, in bad faith, never conducted any inquiry into the facts underlying the complaints, however, or placed members of the industry on notice of the possible miscalculation of the settlement prices. Their bad faith failure in these respects violated the CEA, the CFTC's

regulations, and the Board of Trade's own rules. Compl. ¶¶ 64-73.

By May 2000, the P-Tech futures market became too volatile for Eisler to sufficiently manipulate the settlement price. *Matter of Norman Eisler*, 2004 WL 77924 at *12. Thus, despite Eisler's manipulation efforts, on May 11, 2000, the First West account with petitioner was subject to a margin call of approximately $700,000. Neither Eisler nor First West could meet the margin call and petitioner ordered Eisler to liquidate First West's position. Compl. ¶¶ 80-84.

A day later, on May 12, petitioner contacted an executive vice president of the respondent Board of Trade, who was the officer responsible for financial futures for the Board of Trade and the Exchange. Petitioner expressed concern over Eisler's inability to meet his margin call and the illiquidity of the P-Tech futures market and requested that the Board of Trade take emergency action to halt trading in P-Tech futures. No action was taken, and the market for P-Tech futures became illiquid and collapsed. Compl. ¶¶ 89-91.

On May 15, 2000, the Board of Trade suspended the membership of Eisler. In his absence, the Exchange settlement committee recalculated the settlement price, resulting in a surprisingly and grossly divergent settlement price from the previous trading day's settlement price. Under the new settlement price, First West's margin account debit with petitioner ballooned to $4.5 million. Again, neither Eisler nor First West could meet the margin call and petitioner, as the merchant that engaged in the transactions, was required to take a charge against its net capital in the amount of Eisler's margin call deficiency. The capital charge put petitioner below the CFTC's and the Board of Trade's minimum regulatory requirements and, thus, out of business. Compl. ¶¶ 99-107.

b. Petitioner brought the instant action on July 26, 2000, in the United States District Court for the Southern District of New York against Eisler, First West, and the several respondents, alleging violations of, *inter alia*, the Commodity Exchange Act, 7 U.S.C. § 25(b)(1).[5]

The district court dismissed the case, holding that petitioner lacked standing. App., *infra*, 24a. The court failed to acknowledge that the different rights of action under 7 U.S.C. § 25(a)(1) and under 7 U.S.C. § 25(b)(1) have different standing requirements. Instead, the court applied the standing requirements of Section 25(a)(1) to Section 25(b)(1) as well, incorrectly declaring generally that "Section 22 of the CEA requires that a plaintiff stand in at least one of four possible relationships with defendant" codified at 7 U.S.C. § 25(a)(1)(A) through (D). App., *infra*, 23a.

The district court further held that petitioner failed to meet the requirement of Section 25(b)(1) that it be a person "who 'engaged in any transaction on or subject to the rules' of such contract markets or licensed boards of trade." App., *infra*, 23a. The court ruled that petitioner could not meet that requirement because, in the court's view, petitioner was not a purchaser or a seller of P-Tech futures and "did not suffer its damages in the course of its trading activities on a contract market." App., *infra*, 25a.[6]

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[5] Petitioner also sued under 7 U.S.C. § 25(a)(1) and brought actions under 7 U.S.C. § 25(b)(3) against the individual respondents, Mark D. Fichtel; Albert Weis; Jeff Soman; Charles Sweeney; Al Peres; Chris Meek; George Haase; Lawrence Gulitti; Bryan Ssyler; Nitesh Trivedi; Joseph O'Neill; Walter Fair; Evan Thomas; and Joseph Jach, but petitioner does not seek review of the court of appeals' ruling as to those defendants. Klein did not appeal the dismissal of his complaint against Eisler and First West.

[6] Klein also alleged that respondents' conduct gave rise to state common law causes of action. The district court exercised its discretion to dismiss those claims without prejudice pursuant to 28 U.S.C. § 1367(c), once it dismissed the federal claims. App., *infra*, 26-27a. The

(Continued on following page)

c. The court of appeals affirmed. App., *infra*, 2a. The court acknowledged that Congress created different private rights of action under 7 U.S.C. § 25. The court explained that Section 25(a) "relates to claims against persons other than registered entities and registered futures associations," whereas Section 25(b) "deals with claims against those entities and their officers, directors, governors, committee members and employees." App., *infra*, 7a. But the court ignored the explicit textual differences regarding standing under the two different rights of action and held that all the rights of action, including under Section 25(b)(1), are limited to the four categories of persons described in Section 25(a)(1)(A) through (D).

The court of appeals denied a petition for rehearing and rehearing *en banc* on November 14, 2006. App., *infra*, 35a-36a.

This petition seeks review of the court of appeals' clearly erroneous statutory construction, which is based on a view that futures commission merchants do not engage in transactions on, or subject to the rules of, a board of trade, and which conflicts with the conclusions of other circuits.

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court of appeals affirmed that exercise of discretion in light of an appeal by respondents that the district court should have dismissed the state law claims with prejudice because they were preempted by the CEA. *Id.* at 13a-15a. That portion of the lower courts' opinion is not the subject of this petition.

REASONS FOR GRANTING THE PETITION

THE COURT OF APPEALS' RULING DISRUPTS THE COMMODITY EXCHANGE ACT'S CAREFULLY CRAFTED FRAMEWORK OF EXPRESS PRIVATE RIGHTS OF ACTION THAT PROTECT AGAINST MARKET MANIPULATION IN A CRITICAL SEGMENT OF THE NATIONAL ECONOMY

The decision below rests upon an obvious and fundamental misreading of the Commodity Exchange Act (CEA) and conflicts with the decisions of other courts and the pertinent administrative agency.

The issues presented here are of substantial importance to the futures markets and the economy of the United States because the court of appeals' ruling will have significant adverse consequences for an industry that involves trading worth hundreds of billions of dollars annually. The Commodity Futures Trading Commission (CFTC), which regulates the national futures market, has recognized that the underlying dispute between petitioner and respondents is of great significance to the markets.

The court of appeals denied to futures commission merchants the express right of action conferred by Congress to recover actual losses suffered as a result of the bad faith failure of a board of trade to enforce the statute, bylaws, rules, regulations or resolutions that it is required to enforce by law. Directly contrary to the plain language of the statute, the court of appeals inexplicably grafted standing requirements from one right of action onto a different right of action. Moreover, the court of appeals erred in broadly concluding that futures commission merchants do not meet the statutory requirement of having "engaged in [a] transaction on" or "subject to the rules of" a board of trade despite the statutory requirement that such merchants enter into and execute the transactions and bear financial liability for them. *Nagel v. ADM Investor Servs., Inc.*, 217 F.3d 436, 439 (7th Cir. 2000).

Indeed, Congress enacted the Commodity Exchange Act specifically to require that futures contracts be subject to such rules and to regulate such transactions, 7 U.S.C. § 6(a), which unquestionably include the nearly two billion transactions in which futures commission merchants such as petitioner engage each year.

The ruling below by the Second Circuit conflicts with the longstanding decisions of the Seventh Circuit, the other jurisdiction in which commodity exchanges are concentrated, as well as decisions of other circuits and administrative adjudications of the Commodity Futures Trading Commission (CFTC). Those other courts plainly recognize that futures commission merchants engage in commodity futures transactions and, moreover, are indispensable principals in *every* futures contract. *See, e.g.*, *Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 181 (7th Cir. 1984).

A. The Ruling Below Will Have A Profoundly Adverse Effect On The Futures Industry, A Critical Segment Of The National Economy

The ruling below is fraught with error and yields a result with grave implications for the national economy.

1. The futures industry is a critical driving force behind the economy of the United States and the world. The success of the futures industry and its positive effect is reflected by the shear volume and breadth of transactions that occur annually. In 2005, a staggering 1.55 billion futures contracts were traded in the United States. *See* CFTC, *Futures Statistics by Major Commodity Group, All Markets Combined for FY 1999 – FY 2005*, at 1 *available at* http://www.cftc.gov/files/dea/dmostat_fy05.pdf (last visited Mar. 7, 2007). And, according to the CFTC, over $110 billion is currently invested in the futures markets of the United States. *See* CFTC, *Selected FCM Financial Data as of November 30, 2006*, at 6, *available*

at http://www.cftc.gov/files/tm/fcm/tmfcmdata0611.pdf (last visited Mar. 7, 2007).

Accordingly, it should come as little surprise that the federal government recognizes that boards of trade "are not just typical commercial enterprises, but are commercial enterprises affected with a significant national public interest. Actions that distort prices or otherwise undermine the integrity of the futures markets have broad, detrimental implications for the economy as a whole and the public in general." CFTC, *Conflicts of Interest in Self-Regulation and Self-Regulatory Organizations*, 72 Fed. Reg. 6936, 6938 (Feb. 14, 2007) (to be codified at 17 C.F.R. pt. 38). Futures markets "provide an important hedging vehicle to individuals and firms in a myriad of industries, resulting in more efficient production, lower cost for consumers, and other economic benefits." *Ibid.*; *see also* 7 U.S.C. § 5(a) (finding that "[t]he transactions subject to this Act * * * are affected with a national public interest by providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.").

The futures industry thus serves as a critical means for vital sectors of the economy – from agriculture to manufacturing – to protect themselves, through hedging, from unpredictable price shifts. *See Merrill Lynch*, 456 U.S. at 359 ("A farmer who takes a 'short' position in the futures market is protected against a price decline; a processor who takes a 'long' position is protected against a price increase."). "Such 'hedging' is facilitated by the availability of speculators willing to assume the market risk that the hedging farmer or processor wants to avoid. The speculators' participation in the market substantially enlarges the number of potential buyers and sellers of executory contracts and therefore makes it easier for farmers and processors to make firm commitments for future delivery at a fixed price." *Ibid.*

2. The decision below will disrupt this important segment of the United States economy. If not corrected, the Second Circuit's holding will mean that many who need to hedge against price fluctuations will find the necessary transactions more expensive or so thinly traded as to not provide an accurate indication of the actual value of the underlying commodity.

Under the court of appeals' decision, the futures commission merchants that engage in the 1.5 billion futures transactions annually and bear the ultimate risk of loss in such transactions, are denied their federal cause of action to seek legal redress against a board of trade or clearinghouse that violates in bad faith the laws put in place by Congress to prevent against price manipulation. The ruling thereby shifts market risk onto futures commission merchants away from the very self-regulating entities – the boards of trade and clearinghouses – who have control over enforcement of the rules that prohibit the misconduct that creates this market risk.

Because the ruling below makes commodity exchanges unaccountable to futures commission merchants for bad faith violations of law, merchants will likely mitigate their risk of exposure to losses on such markets. Either of the two primary methods for merchants to accomplish this goal will make the markets less efficient. First, merchants may refuse to participate in riskier markets. That will make those markets more inelastic and reduce the ability of investors to hedge volatile positions. *See Baker v. Edward D. Jones & Co.*, CFTC No. R 76-4, 1981 WL 26078, at *3-4 (C.F.T.C. Jan. 27, 1981). As these risky markets become more inelastic (and more costly in which to transact), hedging investors will lose valuable means of protecting themselves from price fluctuations, which will distort the actual prices for the underlying commodities and make those futures more prone to price manipulation. Farmers and manufacturers in these risky markets will be

forced to pay a premium to hedge against price declines and price increases.

Second, futures commission merchants may mitigate their increased exposure to economic loss stemming from the decision below by demanding higher margins from all or some investors. This approach will make trading more costly, which will make the futures markets as a whole less liquid, particularly if market participants exit certain market segments. *Cf. United States v. Dial*, 757 F.2d 163, 169 (7th Cir.) ("Trading without margin also shifts the risk from the trader to the broker, * * * which would have had to make good on any losses."), *cert. denied*, 474 U.S. 838 (1985). Even minor increases in margins, particularly in more risky segments of the market, will unquestionably affect prices.

This concern is not idle speculation. The instant dispute has garnered substantial attention from many components of the commodities futures industry. For example, the Futures Industry Association, Inc., which has as its members most of the industry's futures commission merchants as well as the exchanges that are subject to suit (*including* respondents Board of Trade and its clearinghouse),[7] has argued that its "clearing firm

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[7] Both respondents Board of Trade and New York Clearing Corporation are associate members of the Futures Industry Association, Inc. *See* www.futuresindustry.org/memberfi-2147.asp (last visited Mar. 7, 2007). The Futures Industry Association, Inc.'s "clearing firm members handle at least 90% of the customer business on U.S. futures exchanges." C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 2.

Notwithstanding this broad coalition of members who face potential liability, the Futures Industry Association, Inc. has unequivocally asserted that the decision below is wrong and needs to be reversed. *See* Brief of Futures Industry Association Inc. as *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc*

(Continued on following page)

members [*i.e.*, futures commission merchants] and the futures industry as a whole [will] be harmed significantly" by the court of appeals' ruling in this case because that ruling "nullifies an important statutory remedy for the bad faith breach of legal duties by self-regulatory organizations for the futures markets." C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir.) at 2.[8]

Indeed, as a result of this underlying dispute, the federal government reevaluated the market risk facing merchants and their customers. Immediately following petitioner's failure, but before the full extent of the underlying unlawful market manipulation was brought to light, the CFTC investigated the incident to prevent recurrences. The government counseled that merchants should find ways to acceptably manage risks. But the CFTC also cautioned that "[m]argin is not designed to cover all possible losses, because if margin levels were set high enough to do so, the products would not be economically viable," CFTC, *Report on Lessons Learned from the Failure of Klein & Co. Futures, Inc.* at 3 (July 2001), which is a plain acknowledgment by the federal government that total mitigation of risk by merchants can and will adversely affect the futures market. Accordingly,

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Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 8.

[8] *See also* C.A. Motion of Futures Industry Association, Inc. For Leave To File Brief As *Amicus Curiae* In Support Of Petition For Rehearing and Rehearing *En Banc* Of Appellant Klein & Co. Futures, Inc., *Klein & Co. Futures, Inc.*, No. 05-1374 (2d Cir. 2006) at 3-4 (faced with the denial of their right of action under Section 25(b)(1) "some firms could reasonably decide to reduce their capital exposure in futures clearing systems. If they do, futures markets would become less liquid causing exchange trading to become more costly and even diverting trades to less transparent (and less regulated) over-the-counter markets.").

the CFTC primarily advocated that contract markets engage in greater merchant oversight, *see id.* at 13-16, 18-19, a result which does nothing to protect merchants from the sort of contract market malfeasance that was subsequently revealed in this case. *See Matter of Norman Eisler*, 2004 WL 77924 at *2. Private enforcement of the CEA for bad faith contract market rule violations thus provides the only means for merchants to protect their financial interests without distorting the futures markets.

The decision below comes at a particularly inopportune time for the futures industry. The CFTC has found it increasingly difficult for boards of trade to maintain adequate self-regulation in the face of increased conflicts of interest. As the CFTC has explained, when boards of trade "were first entrusted with * * * extensive regulatory responsibilities, they were almost exclusively member-owned, not-for-profit exchanges facing little competition for customers or in their prominent contracts." 72 Fed. Reg. at 6938. Today, that is no longer the case and boards of trade

> now face potential conflicts of interest between their critical self-regulatory responsibilities and their powerful commercial imperatives. Specifically, [boards of trade] must: defend and expand their markets against others offering similar products or services; generate returns for their owners; and provide liquid markets where their members and customers may profit. At the same time, they must continue to meet fundamental public interest responsibilities through vigorous and impartial self-regulation.

Ibid.

The CFTC's immediate investigation into petitioner's failure due to respondents' illegal actions and the broad industry support for petitioner are clear indications of the importance of this case. The federal government's concern over the underlying dispute and attendant issues reflected

in the CFTC's report, its administrative actions against Eisler and the Exchange, and its issuance of new rules to eliminate contract market conflicts of interest, also demonstrate a substantial interest of the United States in this case.

B. The Court Of Appeals Plainly Misread The Scope Of The Statutory Private Right Of Action And Misconstrued The Critical Role Played By Futures Commission Merchants, Contrary To The Decisions Of Other Circuits And The Commodity Futures Trading Commission

The decision below is premised upon a fundamental misreading of the Commodity Exchange Act because the court of appeals adopted a narrow interpretation of the statutory language, "transactions on" or "subject to the rules of" a board of trade, which would render the Act internally inconsistent and lead to absurd results.

1. The ruling below stands in irreconcilable conflict with the language of Section 6(a)(1), that futures commission merchants can lawfully conduct business only so long as they enter into or execute transactions on, or subject to the rules of, a board of trade

Congress made clear in the CEA that futures commission merchants must conduct their business by engaging in transactions on, or subject to the rules of, a board of trade. This requirement is an important consumer protection provision that ensures that merchants abide by the rules that Congress requires in order to protect against market manipulation. A transaction that is not subject to such rules is unlawful.

Congress specified that it is:

> unlawful for any person to offer to enter into, to enter into, to execute, to confirm the execution of, or to conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting, or accepting any order for, or otherwise dealing in, *any transaction in, or in connection with*, a contract for the purchase or sale of a commodity for future delivery * * * unless –
>
> (1) *such transaction is conducted on or subject to the rules of* a board of trade which has been designated or registered by the Commission as a contract market * * *.

7 U.S.C. § 6(a)(1) (emphasis supplied).[9]

Moreover, Congress defined futures commission merchants as the entities that solicit or accept orders for futures subject to the rules of a board of trade, 7 U.S.C. § 1a(20)(A), and authorized such merchants to accept "money, securit[y], or property" or to extend credit "to margin, guarantee, or secure" any trades or contracts that result from such orders. 7 U.S.C. § 1a(20)(B). Congress expressly authorized boards of trade to establish rules to authorize futures commission merchants "to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if the contract is reported, recorded, or cleared in accordance with the rules of the contract market or a derivatives clearing organization." 7 U.S.C. § 7(b)(3)(C).

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[9] Transactions which do not fall within 7 U.S.C. § 6(a) are outside the scope of the CEA. *Lachmund v. ADM Investor Servs., Inc.*, 191 F.3d 777, 786 (7th Cir. 1999).

The ruling below ignores this statutory framework. In direct conflict with the clear import of those statutory provisions, the court below held that future commission merchants do not "engage in any transaction on," or "subject to the rules of," a board of trade, which, of course, is the statutory requirement for the private right of action under 7 U.S.C. § 25(b)(1) at issue in this case. According to the court below, petitioner was not engaged in a transaction on, or subject to the rules of, a board of trade because it did not trade or own the contracts at issue, *see* App., *infra*, 11a, and acted only as a guarantor of the underlying transaction, *see* App., *infra*, 12a. The court thus viewed a futures commission merchant as an entity which financially facilitates, but is ultimately unnecessary to, futures transactions.

But the view of the court below cannot be correct because 7 U.S.C. § 6(a)(1) provides that a futures commission merchant *must* engage in such transactions to lawfully participate in the market, as they do nearly two billion times annually. Under the court of appeals' rationale, all futures commission merchants' transactions in connection with "a contract for the purchase or sale of a commodity for future delivery" would be unlawful because the transactions would not be "on or subject to the rules of a board of trade." 7 U.S.C. § 6(a). Clearly, Congress did not intend or contemplate such an interpretation.

2. The ruling below conflicts with decisions of other circuits and the CFTC that correctly interpret the role of futures commission merchants as critical principals who engage in transactions on, and subject to the rules of, the boards of trade

Not surprisingly, the narrow construction by the court below of the role of futures commission merchants in the

futures industry plainly conflicts with the longstanding interpretation of the CEA by other circuits and the CFTC. Those other jurisdictions recognize that the merchants engage in the trades on the exchange as buffering intermediaries between the investors and exchanges. The contrary view of the court of appeals in this case on the role of future commission merchants in the statutory framework creates a conflict of greater importance than is typical because it involves the two courts of appeals with jurisdiction over cases arising out of Illinois and New York, where the nation's most significant commodity exchanges are located and thus where most CEA actions are filed.[10]

a. The Seventh Circuit correctly understands that futures commission merchants must engage in futures transactions on, or subject to the rules of, a board of trade in order for the trades to be lawful. *See Nagel*, 217 F.3d at 439 ("The Commodity Exchange Act requires that futures contracts be sold through commodity exchanges and the futures commission merchants registered on those exchanges, 7 U.S.C. § 6(a) * * *. The section just cited declares futures contracts not sold through commodity exchanges *and registered futures commission merchants* unlawful.") (emphasis supplied, internal citation omitted).

Moreover, the Seventh Circuit repeatedly has recognized that clearing member futures commission merchants are the key intermediaries between contract markets and individual investors. Because Congress provided that an individual investor *cannot* directly engage in a transaction with an exchange, "the contract of sale is actually between

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[10] The largest U.S. exchanges are the Chicago Mercantile Exchange, Chicago Board of Trade, Chicago Board Options Exchange, NYBOT, and New York Mercantile Exchange (NYMEX). NYMEX is physically the largest commodity futures exchange in the World. *See* NYMEX, Who We Are, available at http://www.nymex.com/intro.aspx (last visited Mar. 7, 2007).

the floor trader's clearing member * * *, and the buyer's clearing member." *Bernstein*, 738 F.2d at 181. Those clearing members are the futures commission merchants. As such, it is the futures commission merchant that actually suffers any loss, because it "will have to *honor* the contract whatever the price." *Ibid.* (emphasis supplied).

The fallacy of the contrary decision by the court below in the instant case is underscored in *Bosco v. Serhant*, 836 F.2d 271 (7th Cir. 1987), *cert. denied*, 486 U.S. 1056 (1988), where the Seventh Circuit correctly recognized that a futures transaction cannot occur without the "services of both a clearing member of the Exchange * * * and a futures commission merchant * * *," *id.* at 273, which in the instant case were both provided by petitioner.

Other circuits agree with the Seventh Circuit that it is the futures commission merchants that actually engage in the transactions. *See Bibbo v. Dean Witter Reynolds, Inc.*, 151 F.3d 559, 560 (6th Cir. 1998) ("Futures trades are executed on a customer's behalf *by an FCM*.") (emphasis supplied). *Scott v. Prudential Sec., Inc.*, 141 F.3d 1007, 1013 n.10 (11th Cir. 1998) ("The Commodity Exchange Act regulates those who participate in transactions involving commodity futures. Persons who actively participate in that industry, including futures commissions merchants, * * * must register under the CEA.") (internal citation omitted), *cert. denied*, 525 U.S. 1068 (1999). *Cf. Merrill Lynch*, 456 U.S. at 359-360 ("[T]here are the futures commission merchants, the floor brokers, and the persons who manage the market; they also are essential participants, and they have an interest in maximizing the activity on the exchange.").

b. The decision below is also inconsistent with the CFTC's understanding of the necessary services provided by futures commission merchants (abbreviated by the CFTC as FCM) in futures transactions. Like the Seventh Circuit, the CFTC, in administrative adjudications, has recognized that "[a]n FCM * * * occupies a unique position

in the scheme of futures regulation. * * * [A]n FCM is the one who actually trades futures for the investing public * * * [and] carries out its daily routine through the instrumentalities of the national futures exchanges." *In the Matter of W. Fin. Mgmt.*, CFTC No. 81-18, 1983 WL 29657 at *11 (C.F.T.C. Oct. 14, 1983).

For the reasons discussed above, whether merchants engage in transactions on, or subject to the rules of, a contract market is a significant issue that is inextricably tied to the CEA's scope and directly affects who is vested with a private right of action under 7 U.S.C. § 25(b)(1) to deter statutory, regulatory, and rules violations by boards of trade.

C. The Decision Below Fails To Give Meaning To Congress's Express Inclusion Of Certain Standing Requirements In One Right Of Action But Not In Another

The Second Circuit compounded its erroneous interpretation of the statutory text in this case by ignoring one of the most basic canons of statutory construction: "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (quoting *United States v. Wong Kim Bo*, 472 F.2d 720, 722 (5th Cir. 1972)); *see also Lopez v. Gonzales*, 127 S. Ct. 625, 631 (2006); *Barnhart v. Sigmon Coal Co., Inc.*, 534 U.S. 438, 454 (2002); *INS v. Cardoza-Fonseca*, 480 U.S. 421, 431 (1987).

The court of appeals concluded that petitioner's action under 7 U.S.C. § 25(b)(1) against the Board of Trade could not go forward because petitioner does not fall within any of the four categories of persons described in 7 U.S.C. § 25(a)(1)(A) through (D). App., *infra*, 9a. But Section

25(b)(1) includes no such requirement or even mention of those subdivisions. It is only Section 25(a)(1) and other subparagraphs of Section 25(b), all of which involve actions against different types of defendants, that limit the rights of action to the four categories of persons described in Section 25(a)(1)(A) through (D), not Section 25(b)(1) actions against boards of trade.

Section 25(b)(1) expressly vests a private right of action in a person who engaged in "any" transaction on, or subject to the rules of, a board of trade. That stands in contrast to the text of Sections 25(b)(2) and (3) which provide for suits against registered futures associations and certain employees of registered futures associations and boards of trade. 7 U.S.C. § 25(b)(2), (3). Unlike Section 25(b)(1), these other two sections do not have such an expansive provision regarding what persons may bring suit. Rather, the texts of Sections 25(b)(2) and (3) limit the right of action to persons who engaged in a "transaction specified in subsection (a)," *i.e.*, Section 25(a)(1)(A)-(D). *Ibid.* That makes sense because Congress would want to provide more expansive liability under Section 25(b)(1) for the entities which are the most responsible – boards of trade and their clearinghouses – for protecting the transparency of the market. As such, by subjecting a board of trade or clearinghouse to liability for actual losses arising from any transaction due to their bad faith failure to enforce the CEA, the CFTC's regulations, and their own rules that prohibit market manipulation, Congress ensured that those entities will have a substantial incentive to comply with those provisions.

Accordingly, the court of appeals was wholly unjustified in holding that it was merely congressional inadvertence when Congress decided *not* to incorporate the requirements for a right of action against brokers, merchants and advisors under Section 25(a)(1)(A) through (D) into the right of action against contract markets under Section 25(b)(1). *See Russello*, 464 U.S. at 23 (counseling against assuming that such differences are "a simple mistake in draftsmanship").

The court of appeals' error here is all the more egregious in light of the fact that this Court previously has analyzed the same statutory construction doctrine in the context of this very statute. In *Omni Capital Int'l, Ltd. v. Rudolf Wolff & Co.*, 484 U.S. 97 (1987), this Court held that Congress's omission of a provision in 7 U.S.C. § 25 that exists elsewhere in the CEA does not implicitly incorporate that provision into Section 25. Accordingly, in addressing whether the nationwide service of process provisions set forth in 7 U.S.C. § 13a-1(e) for actions to enjoin or restrain violations also apply to private rights of action brought under Section 25, this Court held that the silence in Section 25 on service of process

> contrasts sharply with the other enforcement provisions of the CEA * * *. We find it significant that Congress expressly provided for nationwide service of process in those sections but did not do so in the new [7 U.S.C. § 25]. It would appear that Congress knows how to authorize nationwide service of process when it wants to provide for it. That Congress failed to do so here argues forcefully that such authorization was not its intention.

484 U.S. at 106 (internal citation omitted).

D. The Second Circuit's Ruling Is Contrary To Congress's Important Purpose In Creating The Section 25(b)(1) Private Right Of Action

The legislative background and purpose of the private rights of action under 7 U.S.C. § 25 further demonstrate that Congress conferred on futures commission merchants a private right of action against a board of trade for actual losses due to bad faith misconduct by the board. The House Conference Report explains that "the amendment [authorizing a private right of action] essentially would authorize private rights of action *by market participants*

but not by members of the public who did not particulate in the market and claimed to be injured in their commercial transactions by declines in commodity prices." H.R. Rep. No. 565, Part I, 97th Cong., 2d Sess. 57 (1982). Accordingly, Congress made a reasoned judgment to allow those who directly engage in transactions on commodity exchanges to sue the board of trade for bad faith conduct that causes actual losses.

Thus, contrary to the ruling below, the Seventh Circuit correctly has recognized that the principal distinction between those who have statutory standing under Section 25(b)(1) and those who do not, is whether the putative plaintiffs actually participated in the market instead of having merely been affected by it. In *American Agriculture Movement Inc. v. Board of Trade*, 977 F.2d 1147 (7th Cir. 1992), that court held that the plaintiffs – an association of soybean farmers who lost money when the price of their crops declined due to fluctuations on the contract market – lacked standing under 7 U.S.C. § 25(b)(1) against the contract markets because their suit was "for speculative damages to assets that are affected by fluctuations in prices on the commodity market but which are not the subject of transactions on such market." *Id.* at 1153 (quoting H.R. Rep. No. 565, Part I, 97th Cong., 2d Sess. 57 (1982)). As such, non-traders, including the farmers and their associations, are "foreclose[d]" from any remedies under Section 25(b)(1) because they did not participate in the futures market, *ibid.*, an impediment that does not apply to merchants such as petitioner. *Bernstein*, 738 F.3d at 181 ("the contract of sale is actually between the floor trader's clearing member * * *, and the buyer's clearing member").

In sum, the ruling below defeats the express intent of Congress that private rights of actions under the CEA serve to help prevent manipulation of the market. As discussed above, futures commission merchants are the entities with the institutional interest and means for bringing actions against a board of trade for bad faith

violations of the CEA, CFTC regulations, and board rules because the merchants are the ones who bear the economic loss of such misconduct. There is no indication in the statutory text or history that Congress somehow intended to carve them out of the rights of action it created, and it would make no sense for Congress to have done so in light of the purpose of the statute.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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MARCH 14, 2007

APPENDIX A

464 F.3d 255

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2005

(Argued: February 3, 2006 Decided: September 18, 2006)

Docket Nos. 05-1374-cv(L), 05-1662-cv(XAP),
05-1702-cv(XAP), 05-1718-cv(XAP)

KLEIN & CO. FUTURES, INC.,

Plaintiff-Appellant-Cross-Appellee,

–v.–

BOARD OF TRADE OF THE CITY OF NEW YORK, NEW YORK CLEARING CORPORATION, MARK D. FICHTEL, ALBERT WEIS, JEFF SOMAN, CHARLES SWEENEY, AL PERES, CHRIS MEEK, GEORGE HAASE, LAWRENCE GULITTI, BRYAN SAYLER, HITESH TRIVEDI, NEW YORK COTTON EXCHANGE, INC., NEW YORK FUTURES EXCHANGE, INC., JOSEPH O'NEILL, WALTER FAIR, EVAN THOMAS, JOSEPH JACH,

Defendants-Appellees-Cross-Appellants,

FIRST WEST TRADING, INC., AND NORMAN EISLER

Defendants-Cross-Appellants,

JOHN DOE 1-10, RICHARD ROE AND PETER POE,

Defendants.

Before:

POOLER AND B.D. PARKER*,

Circuit Judges.

Plaintiff-Appellant Klein & Co. Futures, Inc., appeals the dismissal by the United States District Court for the Southern District of New York (Daniels, *J.*) for lack of standing to bring claims under Sections 22(a) and (b) of the Commodity Exchange Act (CEA), 7 U.S.C. § 25. We affirm.

JEFFREY PLOTKIN, Pitney Hardin LLP, New York, NY, *for Appellant Klein & Co. Futures, Inc.*

GARY D. STUMPP, Stumpp & Bond LLP, New York, NY, *for Appellees First West Trading, Inc. and Norman Eisler.*

HOWARD R. HAWKINS, JR., Cadwalder, Wickerhsam & Taft LLP, New York, NY, *for Appellees NYBOT, et al.*

B.D. PARKER, Circuit Judge:

Klein & Co. Futures Inc. is a futures commission merchant ("FCM") and a clearing member of New York Clearing Corporation ("NYCC"). Klein appeals the dismissal

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* The Honorable Denny Chin of the United States District Court for the Southern District of New York was originally assigned to sit by designation on this panel but recused himself before oral argument. This case is decided by the two remaining members of the panel pursuant to Section 0.14(b) of the Local Rules.

by the United States District Court for the Southern District of New York (Daniels, *J.*) for lack of standing to bring claims against Defendant-Appellees the Board of Trade of the City of New York ("NYBOT"), New York Clearing Corporation ("NYCC"), Norman Eisler, and others (collectively "NYBOT Defendants") under Sections 22(a) and (b) of the Commodity Exchange Act (CEA), 7 U.S.C. § 25. After dismissing Klein's claims under the CEA, the district court declined to exercise jurisdiction over its supplemental state law claims and dismissed them without prejudice. The NYBOT defendants cross-appeal that dismissal. For the reasons set forth below, we affirm. Except as noted, the facts are drawn from the complaint.

As a FCM, Klein facilitated the trading and fulfilled certain obligations of its customers who traded through the NYBOT. Prior to May 2000, Defendant Norman Eisler, whose conduct is the focus of Klein's complaint, was the Chairman of the New York Futures Exchange ("NYFE"). The NYFE is a futures and options exchange designated by the Commodity Futures Trading Commission ("CFTC") as a contract market for the trading of commodities futures and options, including P-Tech Futures and Options ("P-Tech contracts"). Eisler was also a member of the NYFE's Settlement Committee for the Pacific Stock Exchange Technology Index Futures Contract & Options (the "Committee"). The Committee's primary responsibility was to calculate the price of P-Tech contracts for the purposes, among other things, of calculating margin requirements in customers' accounts.[1] Eisler was also a

[1] P-Tech Futures and Options prices are based on a composite index of one hundred technology stocks compiled by the Pacific Stock Exchange. The prices of those stocks and the value of that index may

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customer of Klein and the principal of First West Trading Inc. ("First West"), another Klein customer. Eisler traded in P-Tech contracts for the account of First West. The trades were unsolicited and were made without input or advice from Klein.

Allegedly, Eisler, in his capacity as a member of the Committee, secretly manipulated the settlement prices of P-Tech contracts.[2] This manipulation benefitted Eisler's P-Tech positions but, at the same time, caused Klein to miscalculate the margin requirements for the First West account. Around March 2000, the NYBOT began receiving complaints regarding the P-Tech settlement prices but failed to make proper inquiries or to place Klein or other members of the industry or public on notice of potential irregularities.

In early May 2000, Klein, based on the incorrect settlement prices, computed the required margin in First West's account at $700,000, but Eisler was unable to post that amount. Klein then contacted the NYBOT and expressed concerns regarding the illiquidity of the P-Tech contracts, Eisler's inability to meet First West's margin call, and his inability to liquidate First West's contracts. Klein reported that the First West margin deficit, if not

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change up to the close of trading. Therefore, the Committee was charged with setting the settlement price after the close of the market.

[2] On July 11, 2001, the CFTC filed a complaint against Eisler and First West charging them with manipulation and making false reports under the CEA and CFTC regulations. The CFTC's order, entered with the consent of Eisler and First West but without their admitting or denying the findings, requires them to pay a civil penalty of up to $4,923,000 for violating provisions of the CEA and regulations alleged in the complaint. *In re Eisler,* CFTC Docket No. 01-14, 2004 WL 77924 (CFTC Jan. 20, 2004).

covered, would impair Klein's net capital and cause Eisler significant losses. Klein requested that the NYFE Board halt trading in P-Tech contracts, but no such action occurred.

At that point, the scheme began to unravel. In mid-May, Eisler's NYBOT membership privileges were suspended and he was dropped from the Committee. Once this occurred, the remaining Committee members recalculated the settlement prices and First West's margin deficit ballooned to $4.5 million, an obligation it could not meet. As a result, Klein was required to take an immediate charge against its net capital, forcing it below the minimum required for clearing members of the NYCC and the New York Mercantile Exchange ("NYMEX"). Its membership privileges were suspended and Klein collapsed.

Klein then sued on various claims. Klein's first claim alleged that NYFE violated § 5b of the CEA by failing to enforce its rules, and sought a declaration that NYFE should be suspended as a contract market. Klein further alleged that the NYBOT Defendants violated the anti-fraud provisions in CEA § 4b and 17 C.F.R §§ 33.9 and 33. 10, and the insider provisions of CEA § 9. In addition, the complaint alleged a variety of state law claims.

The NYBOT Defendants moved to dismiss principally on the ground that Klein was not a purchaser or seller of futures contracts or options and, therefore, lacked standing under § 22 of the CEA. They also they [sic] moved to dismiss Klein's state law claims with prejudice on the ground that they were preempted by the CEA. The district court agreed and dismissed Klein's claims under

the CEA for lack of standing. Specifically, the district court concluded:

> Plaintiff Klein lacks standing under Section 22 to bring this suit. Klein does not allege that it was either a purchaser or a seller of P-Tech Futures and Options. Furthermore, Klein does not claim that it traded for its own account. Rather, it is undisputed that *First West,* not Klein, traded in P-Tech Futures and Options. Indeed, Klein claims that these trades were effected "without input, counsel, advice or any type of recommendation whatsoever from Klein & Co." Klein further alleges that it "had no equity or financial interest in the First West account nor did Klein & Co. exercise control over the trade in said account."

Klein & Co. Futures. v. Bd. of Trade, No. 00-CV-5563-GBD, 2005 WL 427713, at *4 (S.D.N.Y. Feb. 18, 2005 (internal citations omitted)).

The court further reasoned that § 22 precluded an action by a plaintiff that "did not suffer its damages in the course of its trading activities on a contract market." *Id.* Without addressing preemption, the district court declined to exercise supplemental jurisdiction over the state law claims and dismissed them without prejudice. This appeal followed.

II. DISCUSSION

We review *de novo* the district court's dismissal of a complaint for lack of standing under Fed. R. Civ. P. 12(b)(1) and 12(b)(6). *See Kaliski v. Bacot (In re Bank of N.Y. Deriv. Litig.),* 320 F.3d 291, 297 (2d Cir. 2003). We review the court's decision to decline supplemental jurisdiction over state law claims for abuse of discretion.

See Valencia ex rel Franco v. Lee, 316 F.3d 299, 304 (2d Cir. 2003).

A. Standing under § 22 of the CEA

CEA § 22 enumerates the only circumstances under which a private litigant may assert a private right of action for violations of the CEA. Section 22 includes two types of claims. Section 22(a) relates to claims against persons other than registered entities and registered futures associations. 7 U.S.C. § 25(a).[3] Section 22(b) deals with claims against those entities and their officers directors, governors, committee members and employees. The text of the two subdivisions requires that a putative

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[3] Section 22(a) provides that proper plaintiffs are parties:

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an o r d er for the purchase or sale of –

(i) an option subject to section 4c of this Act (other than an option purchased or sold on a registered entity or other board of trade);

(ii) a contract subject to section 19 of this Act; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract. CEA § 22(a); 7 U.S.C. § 25(a)(1).

plaintiff fall within one of the four required relationships set forth in § 22(a)(1)(A-D).

The common thread of these four subdivisions is that they limit claims to those of a plaintiff who actually traded in the commodities market. Specifically, the remedies afforded by CEA § 22(b) are available only to a private litigant "who engaged in . . . transaction[s] on or subject to the rules of" a contract market. *Id.* § 25(b)(1)-(3).[4] The

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[4] Section 22(b) reads, in relevant part:

(1)(A) A registered entity that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by sections 5 through 5c, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation or resolution that it is required to enforce by the Commission, or (C) any registered entity that in enforcing any such bylaw, rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such registered entity to the extent of such person's actual losses that resulted from such transaction. . . .

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a registered entity or registered futures association willfully aids, abets, counsels, induces, or procures any failure by such entity to enforce . . . any bylaw, rule, regulation, or resolution referred to in paragraph (1) . . . , shall be liable for actual damages sustained by a person who engaged in any transaction. . . .

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this Act available to any person who sustains a loss as a result of (A) the alleged failure by a registered entity or registered futures association or by any officer, director, . . . or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph 1 or 2 of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution . . . that is alleged to have violated this Act, or any

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section contains another important limitation. Subsection 22(b)(5) provides that the private rights of action against the exchanges enumerated in § 22(b) "*shall be the exclusive remedy* . . . available to *any person* who sustains a loss as a result of" a violation of the CEA or an exchange rule by a contract market or one of its officers or employees. *Id.* § 25(b)(5) (emphasis added).

Klein does not fall within any of the required subdivisions of § 22(a)(1)(A)-(D). To fit under one of the four, Klein must essentially either have (1) received trading advice from Eisler or First West for a fee; (2) traded through Eisler or First West or deposited money in connection with a trade; (3) purchased from or sold to Eisler or First West or placed an order for the purchase or sale through them; or (4) engaged in certain market manipulation activities in connection with the purchase or sale of a commodity contract.

Here, Klein was a FCM and a clearing member of the NYCC that cleared First West's trades through NYCC. Klein does not contend that it purchased or sold P-Tech contracts. Klein was not a trader of P-Tech contracts; nor did it own the P-Tech contracts at issue. To the contrary, Klein's complaint admits that it had no financial interest in the First West account and that all the trades in question were unsolicited by First West. Klein's losses were not the result of its purchases or sales in the commodities market. Klein functioned merely as a broker or agent that earned commissions for handling its customers trades. As a clearing member, Klein cleared

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Commission rule, regulation, or order. CEA § 22(b), 7 U.S.C. § 25(b).

their trades and was obligated to post margins for them as required. Under NYCC Rules governing clearing members, Klein was liable for its own failure to post the required margin on its customers' positions, whether or not Klein collected that margin from defaulting customers such as First West. In view of the provisions of sections 22(a) and (b) expressly limiting the categories of persons that can seek remedies under the statute we conclude, as did the court below, that a plaintiff such as Klein who falls outside those categories lacks standing. *See Water Transp. Ass'n v. ICC,* 722 F.2d 1025, 1028-29 & n.2 (2d Cir. 1983); *see also Am. Agric. Movement Inc. v. Chicago Bd. of Trade,* 977 F.2d 1147, 1153 (7th Cir. 1992) (finding that § 22 of the CEA forecloses remedies on behalf of non-traders), *aff'd in part, rev'd in part on other grounds by Sanner v. Chicago Bd. of Trade,* 62 F.3d 918 (7th Cir. 1995). *Cf. Nicholas v. Saul Stone & Co.,* 224 F.3d 179, 187 (3d Cir. 2000).

Klein's main response to this reading of the statute is that the remedies of § 22 are not limited to those who actually traded and that it has standing because, as the legislative history demonstrates, Congress intended to protect those such as itself who were injured in the course of trading on a contract market. According to Klein, the legislative history shows that Congress's main concern in drafting § 22 was to protect "market participants" who suffered actual losses arising from a transaction on the futures market. Klein contends that Congress intended the restrictions on standing to prevent suits on speculative damages to assets subject to price fluctuations on the commodities markets but which are not the subject of transactions. Affording standing to a FCM, such as Klein, is consistent with these purposes because a FCM that has experienced catastrophic losses, that were caused by a

customer who had engaged in manipulation, has suffered what Congress had in mind: actual, non-speculative damages resulting directly from transactions on a commodities exchange.

This argument founders on the clear text of the statute. Section 22(b)'s remedies are expressly available only to a private litigant who "engaged in any transaction on or subject to the rules" of contract markets or other registered entities. As noted, Klein was not an owner of P-Tech contracts traded by First West. To the contrary, Klein was required by NYCC Rules to keep the options in a segregated First West account and not to co-mingle assets. Klein did not fall within any of the categories enumerated in § 22(a)(1)(A-D). Because we conclude the statute is clear, we decline Klein's invitation to parse the legislative history. *See* 7 U.S.C. § 25(a); *Lee v. Bankers Trust Co.*, 166 F.3d 540, 544 (2d Cir. 1999) ("It is axiomatic that the plain meaning of a statute controls its interpretation and that judicial review must end at the statute's unambiguous terms." (internal citations omitted)).

In the alternative, Klein contends that it has standing under CEA to challenge the NYBOT Defendants as a "forced" purchaser and seller of securities. Klein contends that the Supreme Court in *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723 (1975), after confirming that the federal securities laws confer an implied private right of action, granted standing under § 10(b) of the Securities Act of 1934 to securities brokers as "forced" purchasers or sellers, in situations where they, as clearing members, suffered damages arising from obligations to guarantee their customers' trades. Klein argues that as a FCM and clearing member, it was subject to federal statutes as well as the rules and by-laws of NYBOT, NYFE, and NYCC

that required Klein to maintain funds guaranteeing its customers' transactions on the contract market. In his brief on appeal, Klein asserts that it assumed "a very real investment risk that the commodity contracts its customers traded would maintain or increase in value, a risk that is identical to that taken by any purchaser or seller of a commodity contract who is granted standing under the CEA." In sum, Klein argues that it has standing because it faced essentially the same risks as a purchaser or seller of commodities contracts. We disagree.

It is undisputed that Klein was not a trader of P-Tech contracts. Moreover, Klein did not own the P-Tech contracts at issue. Rather, First West, not Klein, traded in P-Tech contracts. Indeed, as the district court recognized, Klein stated in its complaint that it had no financial interest in the First West trading activity and had nothing to do with its trading decisions. Consequently, regardless of whether the First West trading position rose or declined in value, Klein had no interest in any of the resulting profits or investments losses. As the district court observed, "Klein suffered damages because of its customer First West's inability to cover its margin call. . . . " *Klein*, 2005 WL 427713, at *4. Thus, Klein's loss was a credit loss, not a trading loss.

Because § 10(b) and Rule 10(b)(5) are implied causes of action, their "boundaries are left to judicial inference." *Grace v. Rosenstock*, 228 F.3d 40, 46 (2d Cir. 2000). The securities laws discussed in *Blue Chip Stamps* – § 10(b) of the Securities Act of 1934 and Rule 10(b)(5) – contain no corollary to the express limitations on standing expressly imposed by CEA § 22(b). Section 22 was enacted as part of the Futures Trading Act of 1982 in response to *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S.

353 (1982), where the Supreme Court recognized an implied right of action under the CEA. In response, Congress enacted CEA § 22 but enumerated the only circumstances under which a civil litigant could assert a private right of action for a violation of the CEA or CFTA regulations. *See* H.R. Rep. No. 565, Pt. I, 97th Cong., 2d Sess. 57 (1982), reprinted in 1982 U.S.C.C.A.N. 3871, 3906. Congress went on to emphasize that the private right of action in CEA § 22 "shall be the exclusive remedy . . . available to any person who sustains a loss as a result of" a violation of the CEA. 7 U.S.C. § 25(b)(5). Enforcing the statute that Congress wrote, we conclude Klein lacks standing because it was not "engaged in any transaction on or subject to the rules" of a contract market and did not suffer any "actual losses that resulted from such transaction" as required by § 22 of the CEA.

B. State Law Claims

After dismissing the claims under the CEA for lack of standing, the district court dismissed the supplemental state law claims without prejudice. The NYBOT Defendants, who had argued that the state law claims were preempted by the CEA, cross-appeal on the grounds that the district court should have dismissed Klein's state law claims with prejudice on preemption grounds. We review this dismissal for abuse of discretion. *See Valencia*, 316 F.3d at 304.

It is well settled that where, as here, the federal claims are eliminated in the early stages of litigation, courts should generally decline to exercise pendent jurisdiction over remaining state law claims. *See Kolari v. New York-Presbyterian Hosp.*, 455 F.3d 118, 122 (2d Cir.

2006) ("'in the usual case in which all federal-law claims are eliminated before trial, the balance of factors . . . will point toward declining to exercise jurisdiction over the remaining state-law claims.'") (quoting *Carnegie-Mellon Univ. v. Cohill,* 484 U.S. 343, 350 n.7 (1988)); *Castellano v. Bd. of Trs.,* 937 F.2d 752, 758 (2d Cir. 1991). In deciding whether to exercise jurisdiction over supplemental state-law claims, district courts should balance the values of judicial economy, convenience, fairness, and comity – the "Cohill factors." *See Cohill,* 484 U.S. at 350. The NYBOT Defendants contend that the district court should have retained jurisdiction to decide the important, quintessentially federal question of whether the state law claims are preempted by the CEA. *See Baylis v. Marriott Corp.,* 843 F.2d 658, 665 (2d Cir. 1988) ("One factor that may sometimes favor retaining pendent jurisdiction is when a state claim is closely tied to questions of federal policy and where the federal doctrine of preemption may be implicated.").

Because the decision to retain jurisdiction is discretionary and not a litigant's right, a court is not required either to accept or decline supplemental jurisdiction when a state law claim raises federal preemption issues. *See Kolari,* 455 F.3d at 122; *Valencia,* 316 F.3d at 305 ("In providing that a district court 'may' decline to exercise such jurisdiction, [42 U.S.C. § 1367(c)] is permissive rather than mandatory."); *Baylis,* 843 F.3d at 665 (concluding that the Cohill factors outweighed the federal preemption factor, and that the district court did not abuse its discretion in refusing to exercise supplemental jurisdiction). Following consideration of the

Cohill factors, the proper course is left to the court's discretion.[5] *See, e.g., Motorola Credit Corp. v. Uzan,* 388 F.3d 39, 56 (2d Cir. 2004). Our concern, therefore, is solely whether that discretion was abused and we find it was not.

III. CONCLUSION

For the reasons discussed, the judgment of the district court is affirmed.

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[5] The Cohill factors favor dismissal. When dismissed, this case was in the early stages of litigation. There had been no significant activity aside from the consideration of motions to dismiss. (A 3-7) Comity and fairness also favor dismissal, as it will procure for the parties "a surer-footed reading of applicable law" with regard to the *eight* remaining state law claims. *United Mine Workers v. Gibbs,* 383 U.S. 715, 726 (1966)

APPENDIX B

2005 WL 427713

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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KLEIN & CO. FUTURES, INC.,

Plaintiff,

- against -

BOARD OF TRADE OF THE CITY OF NEW YORK, NEW YORK CLEARING CORPORATION, NORMAN EISLER and FIRST WEST TRADING, INC., et al.,

Defendants.

MEMORANDUM DECISION & ORDER

00 Civ. 5563 (GBD)

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BOARD OF TRADE OF THE CITY OF NEW YORK and NEW YORK CLEARING CORPORATION,

Plaintiffs,

- against -

KLEIN & CO. FUTURES, INC.,

Defendant.

01 Civ. 4071 (GBD)

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GEORGE B. DANIELS, District Judge:

Plaintiff Klein & Co. Futures, Inc. ("Klein"), a futures commission merchant, alleges various claims under the Commodities Exchange Act and state common law against defendants Board of Trade of the City of New York

("NYBOT"), New York Clearing Corporation ("NYCC"), Norman Eisler, First West Trading, Inc. and other named defendants. Plaintiff seeks to recover damages sustained as a result of the alleged manipulation of settlement prices which caused its default and the seizure of its assets. ("Klein I"). Defendants moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(1), 12(b)(6) and 12(h)(3).

In a separate, but related case, NYBOT and NYCC brought suit against Klein & Co. Futures, Inc. seeking to recover the amounts lost by Klein customers after all of Klein's accounts were seized.[1] ("Klein II"). NYBOT and NYCC, in Klein II, moved for judgment on the pleadings and to dismiss Klein's counterclaims.

Defendants' motions in Klein I are granted and Klein's complaint is dismissed. NYBOT and NYCC's motion for judgment on the pleadings in Klein II is denied. NYBOT and NYCC's motion to dismiss Klein's counterclaims in Klein II is granted.

BACKGROUND

Plaintiff Klein & Co. was engaged in commodity brokerage services.[2] As a New York futures commission merchant ("FCM") and a clearing member of NYCC, Klein

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[1] NYCC is the clearinghouse subsidiary of NYBOT. NYCC reconciles and clears all futures and options transactions for the exchanges and subsidiaries of NYBOT and assures the financial integrity of such transactions.

[2] Futures Commission Merchants are individuals, associations, partnerships, corporations and trusts that solicit or accept orders for the purchase or sale of futures and options on futures and that accept payment from or extend credit to those whose orders are accepted. FCMs must be registered with the National Futures Association.

facilitated the trades, and guaranteed the obligations of its customers who transacted on the exchange market of NYBOT.[3] On May 15, 2000, First West Trading, Inc. ("First West"),[4] a Klein customer, failed to meet a margin call and defaulted on $4.5 million in options trades transacted on the New York Futures Exchange, Inc. ("NYFE").[5] Through its account with Klein, First West purchased and sold, among other things, contracts in Pacific Stock Exchange Technology Index Futures Contracts and Options ("P-Tech Futures and Options"). First West's inability to meet its margin call became Klein's responsibility as a FCM. Klein's inability to cover the deficit, in turn, led to the eventual collapse of its brokerage business.[6]

Klein contends that its losses stemmed from the actions of Norman Eisler, a former Klein client, a principal of First West Trading, and most importantly, a member of the P-Tech Futures and Options Settlement Committee. The Settlement Committee's primary responsibility was to calculate the settlement price of P-Tech Futures and

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[3] NYBOT maintains contract markets for the trading of futures contracts and options in commodities such as coffee, sugar, cocoa, cotton and financial products by public customers and other entities.

[4] Defendant First West Trading, Inc. is a New York Corporation in the business of trading commodities. Norman Eisler is alleged to have been "a principal of First West." Complaint at 2, ¶ 6.

[5] NYFE is a futures and options exchange designated by the U.S. Commodity Futures Trading Commission ("CFTC") as a contract market for the trading of commodities futures and options, including P-Tech Futures and Options.

[6] A margin call is a notification to a customer from a brokerage firm that the customer needs to raise the equity level in their account to meet the minimum maintenance margin requirements, either by adding additional equity or by selling margined holdings.

Options.[7] Klein alleges that defendant Norman Eisler, in his capacity as a member of the Committee, "incorrectly set the P-Tech Settlement Price for his own benefit and interest, thereby causing the original margin calculation of P-Tech Futures and Options to be incorrect." Complaint at 28, ¶ 172. Since the settlement price is used to calculate margin at the close of the business day, Eisler's miscalculation of the settlement price caused Klein to "incorrectly calculate the price and margin amount cleared through the NYCC for defendant First West's account." *Id.*, ¶ 173.

Plaintiff claims that on May 11, 2000, "the margin call in First West's account was computed to be Seven Hundred Thousand ($700,000) Dollars." *Id.* at 11, ¶ 80.[8] On May 15, 2000, however, First West's account debit ballooned to $4.5 million as a result of the recalculation of P-Tech Futures and Options prices by the Settlement Committee. The recalculated settlement prices were computed without defendant Norman Eisler, who was

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[7] Options prices are based on some underlying commodity, security or index. In the case of P-Tech Futures and Options, their prices are based on a composite index of one hundred technology stocks compiled by the Pacific Stock Exchange. The prices of those stocks and, therefore, the value of that index may change up to the close. When an option is actively traded, the settlement price is usually the price of the last trade. However, when an option is not actively traded, its last price may not represent the price reflected by the index. The Settlement Committee, therefore, is charged with setting the settlement price after the close of the market.

[8] First West notified Klein that it could not meet the margin call. Plaintiff alleges that it contacted NYBOT to discuss First West's inability to meet it's margin call and the illiquidity of the P-Tech Futures and Options. Klein also informed NYBOT that the margin deficit in First West's account, if not covered by Eisler, would exceed Klein's assets.

stripped of his NYBOT membership privileges earlier in the day. "At the opening of business on May 16, 2000, with such a large margin deficit, and no apparent funding available to cover the margin deficit from First West, Klein & Co. was required to take an immediate charge against its net capital for the amount of First West's margin call deficiency." Complaint at 14, ¶ 102. This immediate charge decreased Klein's net capital below the required $2 million minimum for clearing members of NYCC and the New York Mercantile Exchange ("NYMEX"). Klein's membership privileges were suspended, leading to the collapse of its brokerage business.

Plaintiff filed the instant complaint against multiple defendants ("Klein I").[9] Counts I through III of the Complaint assert claims based on various provisions of the Commodities Exchange Act. Count I alleges that NYFE violated § 5b of the Commodities Exchange Act ("CEA") by failing to enforce its own rules, and seeks a declaratory judgment suspending NYFE as a contract market. Count II alleges that the defendants violated the anti-fraud provision in CEA § 4b and 17 C.F.R. §§ 33.9 and 33.10. Count III alleges that defendants violated the insider trading provisions of CEA § 9. The remaining counts

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[9] Defendants NYBOT, the NYBOT Board, NYCC, NYCC Board, Cotton Exchange, NYFE and the Committee are alleged to have a quasi-governmental role in managing, operating and trading the contract markets. They regulate the industry and conduct investigations in order to provide an orderly, fair market. These defendants are alleged to have "violated their duty to enforce the rules and regulations of the CEA and failed in that supervisory duty by allowing" the manipulation of the P-Tech Settlement Price. The various named and unnamed individual defendants were the officers, directors, and/or committee members of those entities.

assert various state law and common law claims including, among others, negligence, conversion and defamation.

Klein's funds were insufficient to cover the account debit Klein inherited from First West. To cover this loss, NYBOT and NYCC confiscated the segregated accounts of *all* of Klein's clients. Soon thereafter, NYMEX, on behalf of Klein's customers, filed suit against NYBOT and NYCC. NYMEX's suit resulted in a settlement between those parties. NYBOT returned the funds from these segregated accounts belonging to Klein customers. Klein customers then assigned their right to the amounts in these accounts to NYBOT. On May 14, 2001, NYBOT and the NYCC brought suit ("Klein II") against Klein seeking to recover over $4 million that Klein customers "validly assigned to NYBOT ... under the Klein Customer Contract." Complaint of NYBOT and NYCC in 01 Civ. 4071 at 6, ¶ 25, ("NYBOT Complaint"). NYBOT and NYCC contend that "Klein's refusal to pay the Customer Claims in full ... constitutes a refusal to credit the Klein Customers (or their assignees) for deficiencies caused by the default of Klein and other customers, and is thus a material breach of the Klein Customer Contract." *Id.*, ¶ 26.

KLEIN I

Defendants Norman Eisler and First West Trading, Inc. moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(1), 12(b)(6), and 12(h)(3). Eisler and First West argue that the Court lacks subject matter jurisdiction because plaintiff lacks standing pursuant to Section 22(a) and 22(b) of the CEA. Specifically, Eisler and First West contend that plaintiff's alleged relationship to defendants does not fall within one of four required relationships under Section

22(a) of the CEA. Additionally, Eisler and First West argue that plaintiff has not met the standing requirements outlined in Section 22(b), because plaintiff did not engage in transactions on, or subject to, the rules of a contract market under the CEA.

The remaining defendants (collectively, the "NYBOT defendants") separately moved to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) on additional grounds. They argue that plaintiff fails to satisfy the requirements for a private right of action under Section 22(b) of the CEA; that plaintiff lacks standing to assert his claim under § 5b of the CEA; that plaintiff has failed to state a claim of bad faith as required under Section 22; and that plaintiff has failed to plead fraud with particularity as required by Fed. R. Civ. P. 9(b). NYBOT further asserts that this Court has no basis to exercise pendant or supplemental jurisdiction over plaintiff's state law claims once the federal claims are dismissed.

Federal Rule of Civil Procedure 12(b)(6) allows a party to move to dismiss a complaint where the complaint "fail[s] . . . to state a claim upon which relief can be granted[.]" FED. R. CIV. P. 12(b)(6). In reviewing a motion to dismiss, this Court accepts the allegations in the complaint as true and draws all reasonable inferences in favor of the non-moving party. *See Patel v. Searles,* 305 F.3d 130, 134-35 (2d Cir. 2002). Here, a motion to dismiss will only be granted if the plaintiff can prove no set of facts in support of his claim that would entitle him to relief. *See Citibank, N.A. v. K-H Corp.,* 968 F.2d 1489, 1494 (2d Cir. 1992). A court may look at the complaint and any documents attached to, or incorporated by reference in, the complaint. *See Dangler v. New York City Off Track Betting Corp.,* 193 F.3d 130, 138 (2d Cir. 1999).

1. Standing under Section 22 of the Commodities Exchange Act

Section 22 of the CEA requires that a plaintiff stand in at least one of four possible relationships with defendant.[10] Section 22 further provides that private remedies are available only to litigants who "engaged in any transaction on or subject to the rules" of such contract markets or licensed boards of trade. 7 U.S.C. § 25(b)(1)-(3). *See Vitanza v. New York City Board of Trade,* 2002 WL 424699, *5 (S.D.N.Y. March 18, 2002) (finding that "[e]ach of the required relationships involves a situation in which the defendant gave advice related to the sale of commodities or *participated in a transaction related to such sales.*") (emphasis added).

Courts have interpreted this provision to mean that only *purchasers or sellers* on the contract market have a

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[10] Proper parties under Section 22(a) include plaintiffs:

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of –

(i) an option subject to section 6c of this title (other than an option purchased or sold on a registered entity or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

right of action pursuant to Section 22. Non-traders have no such private right of action under the CEA. *See DGM Invs. Inc. v. New York Futures Exchange, Inc.*, 2002 WL 31356362, at *4 (S.D.N.Y. Oct. 17, 2002) (dismissing claim for lack of standing under Section 22 of the CEA by fund operator engaged in commodity transactions where there is no allegation that the operator bought or sold on the exchange); *see also Vitanza,* 2002 WL 424699 at *5 (dismissing claim for lack of standing for failing to adequately plead that plaintiffs have with the defendants one of the four relationships outlined in section 22(a)(1) of the CEA); *see also American Agriculture Movement Inc. v. Chicago Board of Trade,* 977 F.2d 1147 (7th Cir. 1992) (finding that Section 22 of the CEA forecloses remedies on behalf of nontraders).

Plaintiff Klein lacks standing under Section 22 to bring this suit. Klein does not allege that it was either a purchaser or a seller of P-Tech Futures and Options. Furthermore, Klein does not claim that it traded for its own account. Rather, it is undisputed that *First West,* not Klein, traded in P-Tech Futures and Options. Indeed, Klein claims that these trades were effected "without input, counsel, advice or any type of recommendation whatsoever from Klein & Co." Complaint at 8, ¶ 56. Klein further alleges that it "had no equity or financial interest in the First West account nor did Klein & Co. exercise control over the trading in said account." *Id.*, ¶ 57.

Klein contends that as a futures commission merchant and a clearing member, it was subject to federal statutes as well as the rules and by-laws of NYBOT, NYFE and NYCC that required Klein to maintain funds guaranteeing its customers' transactions on the contract market. *See* Complaint at 10, ¶¶ 74-75. Although it is a non-trader,

therefore, Klein argues that it has standing because it was "injured in the course of trading on a contract market." This argument, however, is insufficient to support a finding that Klein had standing under Section 22 of the CEA. In *DGM Investments,* 2002 WL 31356362 *4, another court in this district dismissed the claims of plaintiff DGM for lack of standing. In that case, DGM Investments alleged that as a result of defendant Eisler's manipulation of the settlement price, "DGM's clearing broker advised DGM of a margin call on its accounts . . . , that DGM allegedly met this margin call, as well as another of which it was advised . . . , and that DGM allegedly was unable to meet a third margin call. . . . DGM alleges that as a result of these improper margin calls, it lost its capital and was forced to wind up its affairs." *Id.* at *2. The Court nevertheless found that despite DGM's losses, it neither bought nor sold on the exchange. "By its terms, then, § 22(b) creates the exclusive remedies available to those injured by violations of the CEA, and makes those remedies available only to persons injured in the course of trading on a contract market. It therefore forecloses all other remedies, including any on behalf of non-traders." *Id.*

Klein cannot claim that it bought or sold on the exchange or that it had any interest in P-Tech Futures and Options trading through its customer's accounts. Klein suffered damages because of its customer First West's inability to cover its margin call after the settlement price was recalculated. Quite simply, it did not suffer its damages in the course of its trading activities on a contract market. Klein, therefore, does not have standing to allege a private cause of action under Section 22(b). This finding is consistent with those by other courts in this

district concerning the same defendants, the same issue, and the same alleged scheme as the action presently before this Court. *See Vitanza,* 2002 WL 424699 (dismissing plaintiffs' claims for lack of standing under Section 22 of the CEA). Plaintiff's first three counts, which are all based on violations of the CEA and regulations thereunder, are dismissed.[11]

2. State Law Claims

Defendants urge the Court not to exercise supplemental jurisdiction over plaintiff's state law claims. *See* Eisler and First West Brief at 17, NYBOT Brief at 20. With the dismissal of plaintiff's claims under the CEA and related regulations, all of Klein's remaining claims arise only under state law. 28 U.S.C. § 1367(c) states in pertinent part: "[t]he district courts may decline to exercise supplemental jurisdiction over a claim . . . if – . . . (3) the district court has dismissed all claims over which it has original jurisdiction. . . ." *Id.* Indeed, absent unique circumstances, a federal court should decline to exercise supplement jurisdiction over state law claims when no federal claim survives. As the Second Circuit has explained, "in the usual case in which all federal-law claims are eliminated before trial, the balance of factors to be considered under the pendent jurisdiction doctrine – judicial economy, convenience, fairness, and comity – will point toward declining to exercise jurisdiction over the remaining state-law claims." *Valencia ex rel. Franco v. Lee,*

[11] Defendants also assert that plaintiff fails to state a claim of bad faith and that plaintiff failed to comply with Fed. R. Civ. P. 9(b) in his allegations of fraud. As the Court has dismissed plaintiff's claims for lack of standing, it declines to opine on these other arguments.

316 F.3d 299, 305 (2d Cir. 2003) (quoting *Carnegie-Mellon Univ. v. Cohill,* 484 U.S. 343, 350 n. 7, 108 S.Ct. 614, 98 L.Ed.2d 720 (1988)); *see also Baylis v. Marriott Corp.,* 843 F.2d 658, 664 (2d Cir. 1988) ("The basis for retaining jurisdiction is weak, when as is the case here, the federal claims are dismissed before trial."). This Court declines to exercise supplemental jurisdiction over plaintiff's remaining state law claims. Accordingly, plaintiff's remaining state law claims are dismissed without prejudice.[12]

KLEIN II

In a separate, but related suit, NYBOT and the NYCC seek to recover from Klein over $4 million that Klein held in segregated accounts for its customers. NYBOT and NYCC allege that Klein's unwillingness to make payment to NYBOT and NYCC constitutes a violation of Section 4d(2) of the CEA, as well as a breach of contract under state law. As is standard practice in the industry, clients of brokerage houses often maintain their assets with their brokerage house or FCM. Section 4d(2) of the CEA, 7 U.S.C. § 6d(2) provides that

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[12] Defendants further assert that should the Court exercise supplemental jurisdiction, Counts IV (Breach of Fiduciary Duty), V (Gross Negligence and Bad Faith), VII (Common Law Fraud), and X (Defamation) which "seek to impose state law upon the operations and official actions of a federally chartered self-regulatory contract markets," are preempted by Section 22 of the CEA and should be dismissed with prejudice. NYBOT Brief at 20-21. As the Court declines to exercise supplemental jurisdiction over all of plaintiff's state law claims, it need not review the merits of defendants' preemption argument.

> Such money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.

7 U.S.C. § 6d(2). In its complaint in Klein I, Klein alleges that NYBOT and the NYCC "wrongfully confiscated a sum of money and assets in the amount of approximately Eight Million ($8,000,000.00) Dollars in Customer Funds belonging to customers of Klein & Co. that were held in Klein & Co.'s segregated account at Chase Manhattan Bank. NYBOT and NYCC seized these funds after Klein failed to meet its obligation to pay the amount of First West's margin deficiency.

On May 17, 2000, NYMEX, along with several individual plaintiffs, filed suit seeking to have the funds returned to Klein's former customers. *See New York Mercantile Exchange v. NYBOT,* 00 Civ. 3739 (DLC). On the same day, NYBOT issued a press release stating that their Board of Directors approved a plan designed to "make whole" traders and all other customers who sustained losses as a result of Klein's suspension of membership in the exchanges and the NYCC. On June 30, 2000, NYMEX, Klein's former customers and NYBOT and NYCC reached a settlement whereby NYBOT obtained the right to collect from Klein the amount that Klein allegedly owed its customers whose funds were originally confiscated by NYBOT.[13] NYBOT and NYCC's claims,

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[13] The Agreement and Release signed between NYBOT and NYCC and the individual customers provides that NYBOT and NYCC would

(Continued on following page)

therefore, are based entirely on the premise that Klein still owes its former customers for the amounts that were taken from them, and that such claims are assignable by Klein's former customers to NYBOT and the NYCC.

NYBOT and NYCC allege that Klein's refusal to make payment to them, as assignees of Klein's former customers, constitutes a violation of Section 4d(2) of the CEA, 7 U.S.C. § 6d(2), and 17 C.F.R. §§ 1.20 through 1.22 as well as a breach of contract under common law. Klein, in turn, asserts counterclaims in the Klein II case that are in substance similar to those alleged in his complaint in Klein I. NYBOT and NYCC moved to dismiss Klein's counterclaims. As Klein's claims in the earlier suit were dismissed for lack of standing, his federal counterclaims (Counterclaims One, Two, Three and Four) are likewise dismissed for lack of standing.[14] *See DGM Invs. Inc.*, 2002 WL 31356362 at *4 (dismissing claim for lack of standing under Section 22 of the CEA by fund operator engaged in commodity transactions where there is no allegation that the operator bought or sold on the exchange); *see also*

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return to the customer "the value of the Customer's customer-segregated account with Klein . . . , less loans due Klein or its principals in respect of transactions in the Customer's account with Klein." In exchange for this payment, the customer released NYBOT and NYCC from "any and all claims . . . relating to or arising from the default of Klein and/or First West, including, but not limited to, NYCC's utilization of funds in Klein's omnibus customer-segregated account provided by the Customer." The customer further "assigns to NYBOT . . . all rights, remedies, claims and/or causes of action that the Customer has or may have against Klein and/or First West. . . . " Klein II Complaint, Exhibit B.

[14] Klein's four federal counterclaims in Klein II include: indemnification under the CEA; violations of responsibilities of a contract market under the CEA, violations of § 4b of the CEA and 17 CFR § 33.9 and violation of § 9 of the CEA.

Vitanza, 2002 WL 424699 at *5 (dismissing claim for lack of standing for failing to adequately plead that plaintiffs have with the defendants one of the four relationships outlined in section 22(a)(1) of the CEA). Similarly, this Court declines to extend supplemental jurisdiction over Klein's state counterclaims. *see Baylis v. Marriott Corp.,* 843 F.2d 658, 664 (2d Cir. 1988). Klein's counterclaims are therefore dismissed.[15]

NYBOT and NYCC also move for judgment on the pleadings pursuant to Fed. R. Civ. P. 12(c) on the grounds that Klein's answer and affirmative defenses to the NYBOT complaint fail to raise any issue of fact thereby entitling NYBOT and NYCC to judgment as a matter of law. NYBOT and NYCC claim that "Klein's refusal to make payment to NYBOT and NYCC, as assignees of the Klein Customers, of funds segregated or required to be segregated in full or partial satisfaction of Klein's obligations to pay the assigned Customer Claims constitutes a violation of Section 4d(2) of the CEA, 7 U.S.C. § 6d(2), and 17 C.F.R. §§ 1.20 through 1.22." NYBOT Complaint at 5, ¶ 20. Section 4d(2) of the CEA, 7 U.S.C. § 6d(2) provides that

> [s]uch money, securities, and property shall be separately accounted for and shall not be commingled with the funds of such commission merchant or be used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held

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[15] Klein asserts state law counterclaims for breach of fiduciary duty, gross negligence and bad faith, conversion, intentional interference with contractual relations and respondeat superior.

7 U.S.C. § 6d(2). "Section 4d(2) provides that FCM's must "treat and deal" with a customer's margin funds and property as the property of such customer, and that such funds shall not be commingled with the FCM's own funds or used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held." *In re Chicago Discount Commodity Brokers, Inc.*, 1987 WL 5256, *3 (N.D.Ill. January 5, 1987).

NYBOT and NYCC, however, make no allegations that Klein commingled their customers funds with its own or that Klein used other customers' funds in order to meet the margin requirement of a separate customer which is the *sine qua non* of alleged violations of Section 4d(2) of the CEA. *See Commodity Futures Trading Commission v. Rosenberg*, 85 F.Supp.2d 424, 451-52 (D.N.J. 2000) (finding that broker and his company violated Section 4d(2) of the Commodities Exchange Act (CEA) when the broker deposited funds, albeit a small amount, into an account, commingling them with investor's monies). Indeed, Klein contends, without challenge, that *NYBOT* and *NYCC* seized *all* assets held by Klein, including the funds in question, in the aftermath of First West's failure to meet its margin call.[16] NYBOT and NYCC's claim that Klein violated Section 4d(2) of the CEA is unsupported by the

[16] The agreement and release entered into by NYBOT, NYCC and Klein's former customers provide that "NYCC utilized funds maintained in Klein's omnibus customer-segregated account at NYCC to satisfy this margin deficiency in accordance with NYCC By-Laws and Rules, including funds that had been provided to Klein by the Customer for the customer-segregated account. . . ." Agreement and Release, NYBOT Complaint, Exhibit B.

allegations in their complaint. Their motion for judgment on the pleadings is therefore denied.

The unchallenged fact that NYBOT and its affiliates seized these accounts also makes their second claim against Klein for breach of contract untenable. In order to establish a prima facie case for breach of contract, a plaintiff must plead and prove: (1) the existence of a contract; (2) a breach of that contract; and (3) damages resulting from the breach. *National Market Share, Inc. v. Sterling Nat. Bank,* 392 F.3d 520, 525 (2d Cir. 2004). NYBOT and NYCC allege that "[t]he Klein Customer Contract constitutes a valid and binding contract between Klein and the Klein Customers" and that "Klein Customers were entitled to return of their account balances under the Klein Customer Contract." NYBOT Complaint at 6, ¶¶ 23-24. They further allege that "Klein Customers validly assigned to NYBOT their rights under the Klein Customer Contract." *Id.,* ¶ 25. If Klein's former customers were entitled to the return of their account balances, however, the undisputed facts of this case bring into question who is ultimately responsible for their return. Indeed, the facts show that NYBOT and its affiliates, who were responsible for taking control of these funds, returned these funds to Klein's former customers in the settlement entered in *New York Mercantile Exchange v. NYBOT,* 00 Civ. 3739 (DLC). Moreover, it is unclear whether any valid claims still exist after the settlement was entered into, or whether all claims by Klein's former customers were extinguished in full accord and satisfaction as a result of the settlement.

Furthermore, NYBOT and NYCC's claim that Klein breached its contract with customers is insufficiently supported by the other allegations in the complaint.

NYBOT and NYCC fail to state what actions Klein took or failed to take which breached the agreement with its customers. As alleged, NYBOT and NYCC contend that Klein had a valid and binding contract entitling its customers to return of their account balances. Assuming that these account balances were not returned, the undisputed facts show that Klein's inability to return these balances was due, in no small part, to the fact that NYBOT seized *all* of Klein's assets, even those that Klein held in segregated accounts. Klein was thereby prevented from returning these balances.

Under these circumstances, NYBOT and NYCC's motion for judgment on the pleadings must be denied. In fact, NYBOT and NYCC's claim fails to allege causes of action entitling them to relief. This Court, *sua sponte,* grants NYBOT and NYCC leave to amend, within sixty (60) days of the date of this decision its complaint in order to set forth sufficient factual allegations to support their conclusory claims of Section 4d(2) violations and breach of contract. NYBOT and NYCC's failure to file an amended complaint within sixty days hereof will result in their action being terminated for failure to state a claim, and the matter under docket number 01 Civ. 4071 being closed.

CONCLUSION

For the reasons stated above, NYBOT, First West and Eisler's motion to dismiss Klein's complaint in Klein I (00 Civ. 5563) is granted. NYBOT and NYCC motion for judgment on the pleadings in Klein II (00 Civ. 4071) is

denied. NYBOT and NYCC motion to dismiss Klein's counterclaims in Klein II (00 Civ. 4071) is granted.

Dated: New York, New York
February 18, 2005

SO ORDERED:

/s/ George B. Daniels
GEORGE B. DANIELS
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
THURGOOD MARSHALL U.S. COURT HOUSE
40 FOLEY SQUARE,
NEW YORK 10007

Thomas Asreen
ACTING CLERK

Date:	
Docket Number:	05-1374-cv
Short Title:	Klein & Co. Futures v. Board of Trade NYC
DC Docket Number:	00-cv-5563
DC:	SDNY (NEW YORK CITY)
DC Judge:	Honorable George Daniels

(Filed Nov. 14, 2006)

At a stated term of the United States Court of Appeals for the Second Circuit, held at a Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the day of November two thousand six.

Klein & Co. Futures, Inc.,

Plaintiff-Appellant,

v.

Board of Trade of the City of New York, Inc., New York Clearing Corporation, Mark D. Fichtel, Albert Weis, Jeff Soman, Charles Sweeney, Al Peres, Chris Meek, George Haase, Lawrence Gulitti, Bryan Sayler, Hitesh Trivedi, New York Cotton Exchange, Inc., New York Futures Exchange, Inc., Joseph O'Neill, Walter Fair, Evan Thomas and Joseph Jach,

Defendant-Appellee-Cross-Appellant,

First West Trading, Inc. and Norman Eisler,

Defendants-Cross-Appellants,

John Doe 1-10, Richard Roe and Peter Poe,

Defendants.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Klein & Co. Futures, Inc. Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT:
THOMAS ASREEN, Acting Clerk
by
/s/ Arthur M. Heller
Arthur M. Heller, Motions Staff Attorney

APPENDIX D

Section 22 of the Commodity Exchange Act, 7 U.S.C. § 25 (1999), provided at the time this action was filed:

§ 25. Private rights of action

(a) Actual damages; actionable transactions; exclusive remedy

(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this chapter or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this chapter shall be liable for actual damages resulting from one or more of the transactions referred to in subparagraphs (A) through (D) of this paragraph and caused by such violation to any other person –

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of –

(i) an option subject to section 6c of this title (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 23 of this title; or

(iii) an interest or participation in a commodity pool; or

(D) Who purchased or sold a contract referred to in subparagraph (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

(2) Except as provided in subsection (b) of this section, the rights of action authorized by this subsection and by sections 7a(11), 18, and 21(b)(10) of this title shall be the exclusive remedies under this chapter available to any person who sustains loss as a result of any alleged violation of this chapter. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration.

(3) In any action arising from a violation in the execution of an order on the floor of a contract market, the person referred to in paragraph (1) shall be liable for –

(A) actual damages proximately caused by such violation. If an award of actual damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award; and

(B) where the violation is willful and intentional, punitive or exemplary damages equal to no more than two times the amount of such actual damages.

If an award of punitive or exemplary damages is made against a floor broker in connection with the execution of a customer order, and the futures commission merchant which selected the floor broker for the execution of the customer order is held to be responsible under section 4 of this title for the floor broker's violation, such futures commission merchant may be required to satisfy such award if the floor broker fails to do so, except that such requirement shall apply to the futures commission merchant only if it willfully and intentionally selected the floor broker with the intent to assist or facilitate the floor broker's violation.

(b) **Liabilities of organizations and individuals; bad faith requirement; exclusive remedy**

(1) (A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by section 7a(8) and (9) of this title, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this chapter or any Commission rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 21 of this title or in enforcing any such bylaw or rule violates

this chapter or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the chapter in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this chapter available

to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this chapter, or any Commission rule, regulation, or order.

(c) Jurisdiction; statute of limitations; venue; process

The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action shall be brought not later than two years after the date the cause of action arises. Any action brought under subsection (a) of this section may be brought in any judicial district wherein the defendant is found, resides, or transacts business, or in the judicial district wherein any act or transaction constituting the violation occurs. Process in such action may be served in any judicial district of which the defendant is an inhabitant or wherever the defendant may be found.

(d) Dates of application to actions

The provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the Futures Trading Act of 1982 [January 11, 1983]: Provided, That the enactment of the Futures Trading Act of 1982 shall not affect any right of any parties which may exist with respect to causes of action accruing prior to such date.